

VZCZCXRO2592
RR RUEHLH RUEHPW
DE RUEHIL #0575/01 0771108
ZNR UUUUU ZZH
R 181108Z MAR 09
FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 1918
INFO RHEHNSC/NSC WASHINGTON DC
RUEKJCS/SECDEF WASHINGTON DC
RUEHRC/DEPT OF AGRICULTURE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOG/DEPT OF COMMERCE WASHDC
RHEBAAA/DEPT OF ENERGY WASHDC
RHMFISS/CDR USCENCOM MACDILL AFB FL
RUEAIIA/CIA WASHDC
RHEFDIA/DIA WASHINGTON DC
RHMFIUU/FBI WASHINGTON DC
RUEHDO/AMEMBASSY DOHA 1634
RUEHLO/AMEMBASSY LONDON 9911
RUEHML/AMEMBASSY MANILA 3145
RUEHNE/AMEMBASSY NEW DELHI 4650
RUEHBUL/AMEMBASSY KABUL 0024
RUEHLH/AMCONSUL LAHORE 6959
RUEHKP/AMCONSUL KARACHI 1296
RUEHPW/AMCONSUL PESHAWAR 5886

UNCLAS SECTION 01 OF 03 ISLAMABAD 000575

SIPDIS

SENSITIVE

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [EINV](#) [PGOV](#) [PREL](#) [PK](#)

SUBJECT: IMF Update - "Nascent Stability"

¶1. (SBU) Summary. In a briefing of G-7 countries, the IMF Resident Representative characterized Pakistan's economic situation as "nascent stability." Revealing little new information, he commended the GOP's efforts to meet its numeric goals, but cautioned that tax revenue targets would be difficult to meet and that the global economic situation could throw off predictions. In a separate meeting, Finance Advisor Shaukat Tarin was upbeat about bringing down inflation and interest rates, and told Ambassador that he would ask for eight times Pakistan's quota when he attends the Bank/Fund meetings in April. Japan is concerned that the IMF quantify the amount Pakistan needs for the successful completion of its Stand By Arrangement, but the Fund rep said that the \$4 billion target was not mentioned in the report that will be presented to the Board at the end of March. End Summary

¶2. (SBU) On March 9, IMF Resident Representative Paul Ross (protect) briefed the G-7 embassies in an off-the-record session organized by Italy (as current president). Ross confirmed previous reports that the IMF's first review went well and that the GOP showed strong commitment to meeting its goals. The situation is fragile but stabilizing. Inflation has gone down from 25 to 20.5 percent, the exchange rate has stabilized, and the international reserve position has strengthened, both as a result of the IMF disbursement and increasing demand for Treasury bills. (Note: The latest inflation figures, which came out after the briefing, show that inflation increased slightly, to 21.1 percent, in February. End Note.) Ross reported good progress in targeting those eligible for social safety net programs.

¶3. (SBU) All the quantitative targets have been met - borrowing from the State Bank of Pakistan, level of net assets of the SBP, and budget deficit levels. Plans to strengthen private banks and to deal with circular debt are due by the end of March. The circular debt problem will be addressed quite soon by the issuance of \$1.2 billion of five-year, term finance certificates, at KIBOR (Karachi Interbank Offered Rate) plus 175 basis points. A plan is in place to eliminate electricity subsidies by June 30. Electricity prices are now at cost recovery levels, and the GOP has committed to a cumulative four percent increase by end-June; a one percent increase was announced in early March, but the GOP did not give a timetable for the remaining increases.

Uncertainty due to World Economic Situation

14. (SBU) In spite of the GOP's solid performance, many indicators depend on the state of the world economy and are thus difficult to predict, such as world demand for Pakistani exports, and the levels of foreign direct investment and workers' remittances, both of which currently are higher than expected. Ross said that the decline in portfolio investment was less than the IMF had feared. He predicted that growth and inflation would both decrease, with year-on-year inflation falling to only 10 percent by June, and declining further to 5-6 percent in the next fiscal year. There has been a slight improvement in the balance of payment position (\$6.25 million), due to a smaller current account deficit, although this was somewhat offset by a decrease in the capital account. The IMF expects 2.5 GDP growth this fiscal year, 4 percent in FY09-10, and 6 percent in FY10-11.

Revenue Targets "Ambitious"

15. (SBU) Ross said the mission had discussed next year's budget in broad parameters. There will be an increase in tax revenue targets, and they expect resources to be freed up because of the elimination of subsidies. This year's tax revenue target was reduced by \$750 million to reflect lower nominal GDP and lower inflation. Even so, he characterized it as ambitious, noting that the Fund mission questioned the GOP's ability to raise this amount of revenue on technical grounds, but they said they wanted to keep the targets high, and would cut spending commensurately if revenue fell short.

ISLAMABAD 00000575 002 OF 003

A full-fledged value added tax will be introduced in FY10-11, Ross said; the IMF and World Bank are providing technical assistance on tax reform and tax policy design.

Fiscal Stimulus Not Possible without More Assistance

16. (SBU) In the face of the global financial crisis, many countries are stimulating their economies through lower interest rates and increased government spending, Ross said, but Pakistan did not have adequate reserves to pursue such counter-cyclical policies.

The GOP told the Fund that they want to consolidate the stabilization (inflation and fiscal position) before moving to counter-cyclical measures. While the budget deficit target will be maintained in rupee terms (Rs 562 billion or \$7 billion), due to slowing growth, it will now constitute 4.3 percent rather than 4.2 percent of GDP. In the coming fiscal year, the authorities plan to reduce the fiscal deficit by a further 0.9 percent - from 4.3 to 3.4 percent. The GOP plans to increase development expenditures from 3.2 percent of GDP this year to 4 percent next year.

May IMF Mission to Focus on Next Year's Targets

17. (SBU) The next IMF mission, scheduled for mid-May, followed by a board review/tranche disbursement at the end of June, will work out more detailed targets for the next fiscal year with the GOP. Ross emphasized the need for additional financing to provide some space for counter-cyclical policies. If 0.5 percent of GDP were available to the GOP, it would spend more on social safety net programs, such as health insurance and providing vocational/technical training to one member of the 7 million households that will be targeted for assistance under the Benazir Income Support Program.

\$4 Billion Figure not Specified in IMF Written Report

18. (SBU) In answer to a question from the Japanese economic counselor, who emphasized the need for the IMF to validate Pakistan's assistance needs, Ross reaffirmed that the IMF still estimates Pakistan's needs at \$4 billion over the life of the Stand-By Arrangement (which ends in June 2010). When pressed, he said that this figure was not specifically mentioned in the report

to the IMF Board, however. Ross explained that the figure does not represent the financing gap, but is desired additional funding. (Note: According to an MOF source, the actual financing gap for this fiscal year is only \$100 million. End Note.) Ross noted that the IMF had an adjustor in the program to allow for more expenditure, and that the Fund would prefer that assistance in the form of budget support, or concessional financing, preferably grants.

¶9. (SBU) Ross remarked on the recent press reports in which the GOP asked for a larger multiplier of its quota, wondering why the GOP was dealing with the press rather than approaching the Fund directly. He indicated, however, that the Fund would not necessarily be opposed to increasing its lending.

Tarin Will Ask Fund for More Money in April

¶10. (SBU) Financial Advisor Shaukat Tarin, in a March 13 meeting with the Ambassador, said he planned to ask for eight times the GOP's quota (they are receiving five times quota under the current arrangement) at the upcoming Bank/Fund meetings in order to provide a foreign exchange cushion of 4-6 months of imports to protect the country against exogenous shocks. Tarin also confirmed that revenue targets would be difficult to meet, as 58 percent of all taxes are paid by the manufacturing sector, which is shrinking. He was upbeat on interest rates, noting that KIBOR had fallen from 15.5 percent to 12.5 percent in one month (Note: As of March 16, it had dropped even

ISLAMABAD 00000575 003 OF 003

further, to 11.65 percent. End Note.) Tarin predicted that inflation would drop rapidly, although the sensitive price index (a list of products whose prices affect the poor disproportionately) was up in February due to surges in sugar and onion prices. He said that remittances were growing faster than expected, at 19 percent, and that the \$500 million from the World Bank would be coming in soon, with another \$500 million from IDA and a further \$500 million from the Asian Development Bank before the end of June.

PATTERSON